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POSTAL REGULATORY COMMISSION
Washington, DC 20268-0001

Periodic Reporting (UPS Proposals One, Two, and Three)	:	Docket No. RM2016-2

REPLY COMMENTS OF THE GREETING CARD ASSOCIATION

The Greeting Card Association (GCA) files these Reply Comments pursuant to Commission Order No. 2793. GCA participated in the initial comment phase of this proceeding as a signatory to the Comments of Market Dominant Mailers (American Catalog Mailers Association, et al.). Our Reply Comments principally address the Public Representative Comments, insofar as the Public Representative (PR) supports UPS Proposal One.[1] We also comment on the PR's discussion of how the proposals bear on market-dominant products, a subject largely neglected in UPS's presentation.

I. THE UPS PROPOSAL ONE APPROACH IS WRONG IN PRINCIPLE FOR A MULTI-PRODUCT FIRM, AND FOR THE POSTAL SERVICE IN PARTICULAR

A. *Attempting to "attribute" common costs.* Like UPS, the PR advocates assigning inframarginal costs to products using distribution keys. This approach is not suited to *causation-based* cost allocation for a multi-product firm such as the Postal Service. One can, of course, *assign* the common costs present in a true[2] multi-product firm, as long as one is content to rely on accounting conventions which are not meant to, and

[1] GCA largely agrees with the PR's criticisms of Proposal Two.

[2] As distinguished from a firm which, although a single legal entity, is operationally and financially no more than a collection of single-product firms.

cannot, establish causal relationships. Such a technique is characteristic of fully-distributed costing systems, which the Commission has long recognized as arbitrary and likely to produce inefficient rates.[3]

This approach is in any case foreclosed, as to the Postal Service, by the statutory requirement that cost attribution rest on "reliably identified causal relationships." Section 3631(b)[4] defines "costs attributable" as those associated with individual products through such relationships. Section 3622(c)(2) enacts the same principle as a factor to be considered by the Commission in establishing the present ratemaking system. The Commission and the Postal Service are thus not free to assign inframarginal costs on a non-causal basis.

B. *Variability does not entail attributability, as that concept is defined in the statute.* The PR argues that the distribution keys used to allocate volume variable costs to products should likewise be used on inframarginal costs since ". . . there is no reason to distinguish inframarginal cost from other variable costs, since inframarginal costs are incurred in tandem with volume variable costs."[5]

As to some types of enterprise this may be a defensible view.[6] But the Postal Service, as a multiproduct firm, is not such an enterprise. The UPS/PR premise cannot be the basis of attribution under the Postal Service's statutory regime because mere variability does not establish the required causal connection between cost element X and product Y. Inframarginal costs result from the simultaneous production of many goods. As Prof. Bradley explains,

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[3] See, e.g., PRC Op. R84-1, ¶¶ 3020 et seq.; PRC Op. R87-1, ¶ 3025, fn. 8.

[4] Section citations standing alone refer to title 39, United States Code.

[5] PR Comments, p. 29.

[6] If the Postal Service were a single-product firm, it would be true; and if it were a "pseudo" multiproduct firm (i.e., a cluster of operationally unrelated single-product firms) it would be true of each member of the cluster. But this counterfactual helps explain why it is not true here.

> . . . [I]n a multiproduct firm, the fact that a cost is variable, does not, by itself, justify its attribution to any specific product. In multiproduct firms, there can be variable costs which are not caused by any individual products. To justify the attribution of costs to products in multiproduct firms, a causal link must be established as is done for marginal and incremental costs.[[7]]

For this reason, variability alone does not satisfy the requirement of "reliably identified causal relationships," and thus cannot ground a lawful attribution under the statute. Neither the PR nor UPS has identified, or suggested a means of identifying, such causal relationships independently of the mere fact of variability.[8]

The PR cites Prof. Panzar to support the notion that inframarginal costs can be distributed to products using distribution keys.[9] It is far from clear, however, that the passage cited actually supports his position. Prof. Panzar distinguishes, as the PR does not, between *distributing* costs and *attributing* them. At pp. 13-14, he observes that

> The end result of the CRA process is the determination of the *attributable costs*, A_i, of each individual postal product. This is obtained by adding any specific-fixed costs, F_i, associated with the product to the product's volume variable cost. This gives rise to another specialized postal cost term:
>
> <u>Definition P3</u>: *ATTRIBUTABLE COSTS.* The attributable costs of a product *i* are equal to the sum of that product's specific-fixed costs and its volume variable cost: i.e., $A_i = F_i + VVC_i$.

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[7] Michael D. Bradley, *Analysis of UPS Proposals One and Two, and the Supporting Report of Dr. Kevin Neels,* p. 29 ("Bradley Analysis").

[8] Where such a relationship can be shown, it may be possible to attribute even fixed costs (or, perhaps, "quasi-fixed" costs; see Bradley Analysis, pp. 5-6). This can happen, for instance, when we identify a product-specific cost. Another example, from pre-PAEA practice, is the Commission's 1980s treatment of the fixed portion of Special Delivery Messenger costs (former Cost Segment 9). See PRC Op. R84-1, ¶¶ 3035 et seq. and App. J, Cost Segment 9. Just two classes (Special Delivery and Express Mail) were, as a matter of mail classification definitions, entitled to the services of a Messenger when necessary to meet their service commitments. The Commission argued that since the causal relationship rested on an explicit service entitlement – intrinsically a piece characteristic – pieces was the proper distribution key, and the fixed (or quasi-fixed) cost element could be attributed to the only two relevant categories on a volumetric basis. This historical example is of interest because variability had nothing at all to do with the attributability of the cost element – which was uncontroversially treated as fixed – and the causal relationship to the two classes was based on facts about the mail classification schedule.

[9] PR Comments, pp. 29-30, citing John C. Panzar, *The Role of Costs in Postal Regulation,* pp. 12-13.

In the passage quoted by the PR, Prof. Panzar points out that what he calls "distribution" of variable cost to products does not mean that the products *caused* those costs. He is, in other words, addressing only one part of the question raised by the UPS proposal.

Logical issues. We can treat the PR's argument as resting on the premise that there is no difference, or none significant for present purposes, between volume variable (marginal) costs and inframarginal costs, since both are variable. Therefore, he argues, both should be attributed, using distribution keys in the same way for both. Simplifying somewhat:

1) X is a variable cost.
2) Every variable cost is caused by products.
3) Y is a product.
4) Therefore Y causes (some of) X.

The "(some of)" in (4) is to be taken care of by the distribution key. Propositions (1) through (3), considered by themselves, are more or less uncontroversial as just written. For the PR's argument to be valid, however, (2) would have to be rewritten as

2') Every variable cost is caused uniformly by all products.

Only on this basis might we be able to say that a distribution key could identify a causal relationship between Y and X. But proposition (2') is clearly not true. For it to be true, it would have to be the case that, e.g., some of the variable cost of parcel sorting was caused by letters and cards. In its Initial Comments, the Postal Service appositely cites the Commission's endorsement of "[costing] judgments soundly based on *analysis of postal operations* assisted by functional data and relevant economic concepts."[10] That is what is missing in Proposal One and Dr. Neels' supporting paper, and the PR has not

[10] Initial Comments of the United States Postal Service, p. 3, citing PRC Op. R76-1, p. 96 (italics added).

filled the gap. Because it fails (and indeed scarcely tries) to establish the causal relations necessary for cost attribution, Proposal One cannot be adopted.

II. THE QUESTION OF MARKET-DOMINANT PRODUCTS

In our Response[11] to UPS's original Petition, we emphasized the importance of investigating how Proposals One and Two would affect the market-dominant sector. It is fair to say that UPS itself soft-pedaled this issue. Dr. Neels's paper indicated that the percentage increase in attributable costs for market-dominant products would be greater than that for the competitive sector, but product-by-product details were not forthcoming until UPS responded to CHIR No. 1, Questions 5 and 12(c).

The PR's treatment of this question is somewhat inconclusive. He recognizes, correctly, that the Proposals would substantially raise the attributable costs of market-dominant products, including particularly those now not recovering attributable costs.[12] He observes – what is also correct, as far as it goes – that

> A factor for Commission consideration is that acceptance of the proposed attribution methodology to competitive products is [sic] the likelihood that, for consistency, the methodology should at some time also be applied to market dominant products, either in this rulemaking or in another docket.

Some discussion of how it would be possible to maintain, even temporarily, two inconsistent approaches to attribution would have been helpful. It has long been accepted that, once it finds a reliable causal relationship, the Commission may not opt out of using it. The Supreme Court laid down this principle in *NAGCP IV*[13], and it has been observed since. If we assume, purely for argument's sake, that Proposal One does identify, or allow us to identify, a reliable set of causal relationships, then it is not clear how

[11] Response of the Greeting Card Association to Petition of United Parcel Service (October 15, 2015).

[12] PR Comments, pp. 6-7.

[13] *National Association of Greeting Card Publishers* v. *U. S Postal Service,* 462 U.S. 810, 830 (1983).

the Commission could treat its application to market-dominant products as a “likelihood” rather than a necessity, or postpone it to a different docket.

This problem arises partly because UPS’s approach is based essentially on components rather than on products. (This, of course, is one of the things wrong with it.) If a cost component is utilized by both kinds of products, is the Commission to attribute its inframarginal element to competitive products, and not to market-dominant products, at least until it makes the decision to do so? Such a situation seems untenable.

On this view, which GCA believes is the correct one, the Commission – before making even a tentative decision about Proposals One and Two – would have to consider the effects of those proposals on market-dominant mail just as comprehensively as it looked into their effects on the competitive sector. Even if the Commission were inclined to believe that adopting (either of) them could be worthwhile on the competitive side, it should be equally prepared to find that their harmful effects on market-dominant products outweighed any such benefit and required it to reject them.

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Respectfully submitted,

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